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ENERGY
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November 1, 2002

California Energy Commission
Attn: Docket Office
1516 Ninth Street, MS-4
Sacramento, CA 95814-5512

Dear Commission:

RE: Independent Energy Producer's Association Comments on the
Proposed Scope of the
2003 Integrated Energy Policy Report
Docket Number 02-IEP-01

The Independent Energy Producers Association (IEP) appreciates the opportunity to comment on the proposed scope of the Commission's 2003 Integrated Energy Policy Report (Report) mandated by SB 1389 (Chapter 568, Statutes of 2002).

IEP represents independent power producers and energy marketers who control or operate over 20,000 MW of installed capacity in California, including non-renewable, renewable and cogeneration facilities. IEP participated in the Commission's October 22, 2002 Hearing on proposed issues for the Report, and offers these initial comments following that Hearing.

Overall Report Scope

SB 1389's mandates are broad. In its initial proposal, staff has made an admirable first cut at organizing and structuring the Report and the analyses that must precede its preparation. The Report has the potential to provide a much-needed analytical foundation for energy planning in California. Tremendous care must be taken, then, to ensure that, the Report truly is "focused and selective rather than being expansive" (Staff Proposal, p. 2), in order for it to be useful.

The discussion of potential issues represents the greatest risk of losing focus in the development of this Report. The four thematic issues (Infrastructure

and Constraint Implications; Adequacy, Reliability, and Risk; Prices, Volatility, and Consumer Response; and State and Global Environment) are important and should be considered in the Report. However, care should be taken to avoid making exploration of these issues overly broad. While IEP agrees with Southern California Edison's comments that questions regarding capital investment, permitting and fuel diversity, for example, are all significant considerations, IEP simply cautions against expanding the scope to include all of the many questions that could potentially be raised over the next year.

Demand Trends and Outlook

IEP believes that an accurate electricity demand forecast must include an evaluation of the expected diligence and persistence of voluntary conservation measures throughout the forecast period. To rely on an evaluation of current trends (i.e., the extent to which conservation continues to dampen demand growth) might lead to a skewed result. As the Commission is well aware, and recent CAISO reports indicate, conservation efforts seen during 2000-2001 are diminishing, leaving a fleeting and uncertain impact, an impact that makes measurement or forward forecasts difficult.

IEP is encouraged by the multi-agency effort to investigate demand response programs. Critical to this analysis should be an empirical assessment of the persistence of demand response programs under various market/price scenarios, as well as the elasticity of demand in terms of being able to absorb additional increments of energy efficiency. However, it is not clear whether the results of those pilot programs will be available in time to be incorporated into this Report. As a result, while recognizing the impressive response of participants in these programs in 2000-2001 and noting that the persistence of demand response programs over time in the context of a competitive marketplace is relatively unmeasured, IEP recommends that the Commission exercise care when considering the potential impact of demand response programs in meeting peak demand, capacity reserve margins, etc.

Supply Trends and Outlook

IEP recommends that the supply trends analysis not be limited to simply identifying "[t]he progress of new infrastructure projects in California and throughout the West." (Staff Proposal, p. 4) As interested parties are well aware, in light of current economic conditions, including diminished demand, many of these projects have been temporarily suspended or canceled. Without these projects, California can be expected to face severe supply adequacy problems in the near term – a likely conclusion of the Report.

IEP therefore believes the Report must investigate the causes of the decline in project development activity in the face of this need, and address the fundamental market structure and regulatory certainty issues that are at the root of this problem (see comments on "Market Design" below). Without addressing these issues and identifying the changes necessary to encourage new generation, the Report cannot assume that the needed projects will be developed during the forecast period.

Potential retirement of generating units will be an important consideration when developing electricity supply forecasts. Given the age of many existing units and the need for expensive overhauls and emissions retrofits, many existing plants will likely be retired during the forecast period. Similarly, many projects will reach the end of existing power purchase agreements during the forecast period and should not simply be assumed to continue in operation without consideration of financial and contractual issues.

In addition, the CPUC is developing a portfolio approach for utility resource procurement that must be reflected in the report. Scenarios should not simply reflect an all-gas or all-renewables/conservation world but should instead also explore the benefits of pursuing a balanced portfolio. As IEP has articulated elsewhere, a valid, sustainable resource procurement plan should recognize the role of all resource opportunities, across multiple product descriptions and acquired through short-, intermediate-, and long-term contractual vehicles, with an opportunity for competition among all such options.

Market Design

SB 1389, Section 25303(a)(6) refers to the evaluation of whether markets are meeting the public interest objectives and (7) refers to the identification of impending or potential problems or uncertainties in the electricity and natural gas markets, potential options and solutions, and recommendations. Specifically, Section 25303 (a)(6) states:

"This evaluation may [emphasis added] consider the extent to which California is an element within western energy markets, the existence of appropriate incentives for market participants to provide supplies and for consumers to respond to energy prices, appropriate identification of responsibilities of various market participants, and an assessment of long-term versus short-term market performance. To the extent this evaluation identifies market shortcomings, the commission shall propose market structure changes to improve performance.

IEP strongly urges the Commission to address the matters raised in Section 25303(a)(6) and (7), as we believe these issues are at the heart of the existing and (potential) future energy problems faced by Californians.

The evaluation of "market shortcomings" needs to include an assessment of the relationship between "regulatory and political certainty" and market performance, infrastructure development, etc. Infrastructure development drives in whole or in part market performance, and infrastructure development is dependent on financial institutions investing in California. To what extent does "regulatory and political uncertainty" effect this investment and, if so, what are its ramifications (e.g. lack of investment and/or higher costs for investment that moves forward)?

State and Global Environment: Transportation System Interface with Electricity Supply

In its written comments on the "worst case" planning scenario, the South Coast Air Quality Management District (SCAQMD) raises some interesting points regarding the interplay between transportation and electricity demand. IEP would like to add a further element to the mix: The role of mobile source pollution vis a vis the ability to site new electricity generating plants.

California's plans for compliance with the federal Clean Air Act must include an equitable balance between stationary sources and mobile sources, and implement cost-effective solutions to meet the prescribed goals. To the extent that an equitable balance is not achieved, then costs may shift inappropriately to one sector or the other. As the Commission is well aware, Emission Reduction Credits (ERCs) for stationary sources are both prohibitively expensive and extremely difficult to obtain. Presuming that an equitable reduction in mobile source pollutants between stationary and mobile sources is not achievable in California, what will be the effect on stationary sources, including electric generation? IEP anticipates that, if such a scenario were to arise, then further pressure would be placed upon stationary sources including electric generators to bring the state into compliance with federal air quality requirements. Thus, IEP urges the Commission to assess the trends in this area, and we note that additional pressure on stationary source emissions could have a detrimental and potentially chilling effect on the ability of the generation sector to meet increasing demand.

Coordination with other Entities

Regulatory Bodies

SB 1389 both encourages and mandates coordination and consultation with a variety of state regulatory bodies to "assure collaborative development of state energy policies" (Pub. Res. Code Sec. 25302(e)). Successful collaboration is imperative if the Report is to be a truly useful document that is neither a political tool nor an expensive exercise that is ignored and unused.

PG&E states in its comments that there are several regulatory proceedings currently underway that should impact both the scope of the Report and its conclusions. These include, but are not limited to, the CPUC's generation procurement process, the CPA's rulemaking establishing a target reserve level, and CAISO's market redesign initiatives.

While not mandated in statute, IEP suggests that it might be useful for Commission staff to convene an interagency working group (consisting of the CPUC, ORA, CARB, EOB, CAISO, CDWR, CPA, CalTrans and DMV) to facilitate a comprehensive and global view of the future of the state's energy system. This will ensure that the Report presents a complete picture and not simply the perspective of one energy agency.

However, having suggested coordination among the various state agencies through interagency working groups, IEP urges the Commission to recognize the fundamental importance of allowing market participants to obtain, review, and comment on key data that will underlie the Report's Findings, Conclusions, and Recommendations. The need for "peer review" will be critical to avoid situations in which the state (or staff) issues reports based on erroneous data and/or assumptions.

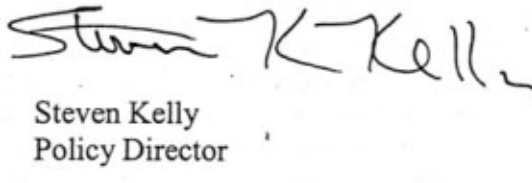
Market Participants and other Stakeholders

Critically, energy market participants' roles and responsibilities must be identified and resolved, and the State must ensure the accountability of all participants. For example, load-serving entities (LSEs), while responsible for supplying power to load, were not held accountable if they failed to plan for and/or acquire appropriate reserves during the initial implementation of the California energy market (i.e. 1998-2002). IEP recommends that, in this example, LSEs be held accountable to their customers for any consequences, especially cost impacts, of a flawed procurement strategy. The absence of such accountability will undermine statewide efforts to ensure adequate reserves. IEP hopes that the Report will strive for clarity and consistency as it identifies the roles and responsibilities of market participants and other stakeholders.

Conclusion

IEP appreciates the opportunity to provide these comments and hopes they will be helpful as the Committee further clarifies the scope of the Report. IEP encourages the Committee to ensure that the Report is "focused and selective rather than being expansive," is free from political considerations and is based upon an unbiased investigation and analysis of available data. IEP looks forward to working with the Committee and staff to develop a useful document to guide California energy policy into the future.

Respectfully submitted

A handwritten signature in black ink that reads "Steven Kelly". The signature is stylized, with a large, looped "K" and a long, sweeping underline that extends to the right.

Steven Kelly
Policy Director

November 1, 2002